Blue Ribbon Commission
Financial Resources and Expenses

Draft Subcommittee Reports
January 11, 2007

Committee #1 – Forecasting
Committee #2 – Capital Planning
Committee #3 – Closing the Gap

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NEWTON BLUE RIBBON COMMISSION

Report of the Forecasting Subcommittee

Mission of Subcommittee

Our subcommittee was asked to "look at the assumptions about revenues and expenditures to determine if the [city's] forecast for the next five years is within the range of reasonable projections."

With one notable exception (maintenance of the city's physical infrastructure and plant), we interpreted this request as an exercise in vetting the assumptions of the city's current forecast rather than modeling various policy options or changes in current financial and management practices. This distinction between inspecting current assumptions and proposing new policies is an important, but sometimes blurred one. To clarify this distinction, consider the following: The subcommittee did not, for example, build a new forecast around what its members might subjectively determine to be a more appropriate property tax rate. We did, however, examine the assumed rate of growth in property tax revenues at the current tax rate. This examination took into account such matters as new property construction and the balance between the size of the city's residential and commercial tax base. In sum, with the single exception of capital maintenance, we looked at expected cash inflows and outflows under the current policy framework. We reserved for the accompanying narrative any potential changes in policy and practices that seem to merit further consideration.

Methodology

The subcommittee adopted as its base case the five-year forecast prepared by the Mayor's Office, in collaboration with the Board of Aldermen, the School Committee, and the Comptroller's Office during the spring of 2006 ("the City's Forecast"). We then identified in this forecast those items that had the greatest impact on the future surplus or deficit of the city's operating budget. For each of these critical items we examined the underlying assumptions of the City's Forecast and assessed their realism in light of Newton's past experience, expert testimony from key city officials, and our best judgments of "what was inevitable." In several instances our assessments led to revised assumptions about what is driving an increase or decrease in revenues and expenditures. We then integrated these revised assumptions into a new forecast called "the Commission's Forecast."

The principal output of this analytical work includes (1) a summary of the assumptions embedded in each forecast, (2) the five-year forecasts themselves, and (3) an accompanying narrative that either further explains the subcommittee's revisions or highlights issues for the full commission and the public-at-large to consider.

We should stress that the forecasts presented here are, by their nature, estimates of future events, which cannot be known with certainty (there are no facts about the future). While we believe the forecast and the accompanying narrative presented here are reasonable and directionally correct, it is likely that future revenues and expenditures will differ from the figures presented here.

We also want to acknowledge at the outset the professionalism of the above-mentioned parties who prepared the initial City's Forecast. This preliminary forecast, which represents the first effort of city government to move from an annual budget process to a process that looks several years into the future, was presumed to be a starting point of a more detailed five-year operating budget forecast. The Blue Ribbon Commission considers this initial effort at multi-year budgeting to be both a bold and skilled exercise. Finding the right balance between projections, predictions, and pure speculation is never an easy exercise—even after all the relevant (and correct) quantitative data has been assembled. Although the forecast of the Blue Ribbon Commission differs in some important respects from that of the city, we want to acknowledge the fact that the city's base case forecast provided us with a truly excellent point of departure for further consideration and revision.

Finally, the subcommittee was ably assisted in preparing its revised forecast by the testimonies and expertise of the following city officials who were interviewed in the course of our work:

Susan Burstein, Chief Budget Officer
Elizabeth Dromey, Chair of the Board of Assessors
Sandy Guryan, Assistant Superintendent for Business and Finance, Newton School Dept.
Michael Kruse, Director of Planning and Development
Sandy Pooler, Chief Administrative Officer
Robert Rooney, Commissioner of Public Works
Edward Spellman, Treasurer
David Wilkinson, Comptroller

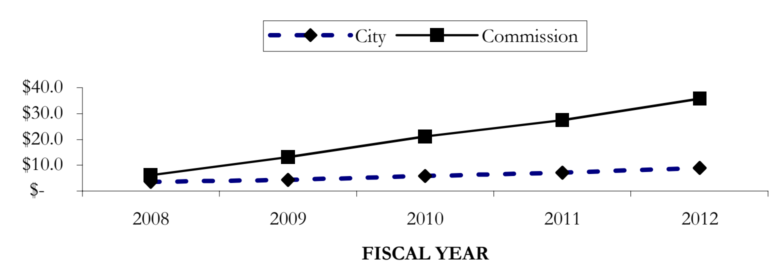
Summary of Findings

Our subcommittee's analysis predicts that Newton's revenues (or sources of funds) will be larger than the City's Forecast for each of the next five years. Unfortunately, our sub-committee's analysis also shows expenditures (or uses of funds) growing much faster than the City's Forecast, dwarfing the revenue growth. Thus, the subcommittee shows a significantly larger deficit in each of the fiscal years for 2008-2012 compared with that in the City's Forecast. By FY2012, we see Newton facing a $35.7 million budget deficit, or roughly 10% of revenues. In other words, the city is facing a structural deficit, not a one-year deficit. This deficit will expand over the next five years at a rate that is likely to exceed that already assumed in the City's Forecast.

Assuming an increase in state aid of $1.4 million each year, the City's Forecast shows Newton's deficit increasing from $3.6 million in 2008 to approximately $9.0 million in 2012. The Commission's Forecast shows this deficit rising from $6.1 million to $35.7 million over the same period.

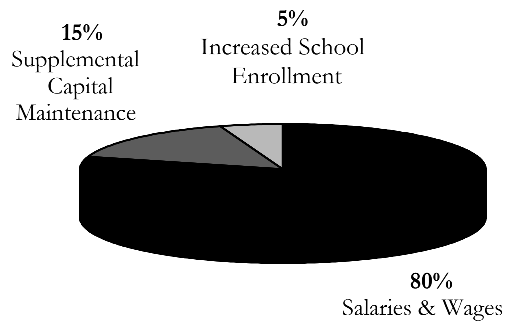
Figure 1 below shows the increasing gap between forecasted revenues and expenditures from 2008 to 2012. As Exhibit 3 (attached) shows, a big chunk of this increasing "gap" reflects the inclusion of a much-needed supplemental capital maintenance budget. Without this supplemental item the subcommittee still sees the city deficit growing to $20.4 million in 2012.

Figure 1
CITY OF NEWTON MULTI YEAR BUDGET FORECAST



While the *accumulated* deficit over the forecast period projected by the city totals approximately $30 million, the subcommittee projects a number closer to $100 million. As depicted in Figure 2 below, three items account for most of the $70 million difference: salaries and wages (80% of difference), supplemental capital maintenance (15%), and increased school enrollment (5%).

Figure 2
MAJOR SOURCES OF DIFFERENCE BETWEEN CITY AND COMMISSION FORECASTS
(in percent)



Readers should bear in mind that due to the mathematics of compounding, a seemingly minor initial difference between faster expenditure growth and slower revenue growth can have a profound impact over a five-year period. This is what Figure 1 on the preceding page shows so graphically. The $35.7 million deficit forecasted by the subcommittee for 2012 represents, for example, a difference of 2.3 percentage points in the annual growth rate of expenditures (5.5%) over revenues (3.2%)

Exhibit 1 attached to this cover memo lists the major assumptions of both the City's Forecast and the Commission's Forecast. Exhibit 2 presents a summary page of the City's Forecast. Exhibit 3 presents the Commission's Forecast.

As noted above, some of these assumptions deserve a special narrative or explanation. These appear in the following section.

Narrative

Both the City's and the Commission's Forecasts are divided into Financial Sources of Funds and Financial Uses of Funds. The Financial Sources panel in the Commission's Forecast reflects the subcommittee's sense of what revenues are "most likely." The forecasts included in the Financial Uses panel reflect our understanding of what expenditures are essential to keep the city's policies and priorities in place.

Even a casual review of the forecasts reveals that the big line items are Property Taxes (a source of funds) and Salaries, Benefits, and Pension Contributions (uses of funds). The assumptions for each of these items, along with a selection of other important line items, are elaborated below. Readers should be comfortable relying on Exhibit 1 for all other assumptions.

Before turning to this narrative, we should point out that the Commission's Forecast integrates expenditures related to currently expected increases in student enrollment in the city's schools that were not foreseen at the time of the City's Forecast. To be more specific, Newton's public schools see enrollment increasing by about 230 students, or approximately 2%, each year over the next several years. Additional costs related to this increased school enrollment will affect salaries & wages, benefits, utilities, supplies & materials, and capital outlays.

Property Taxes. The commission's property tax forecast is based on the $2.2 million of FY 2007 new growth increased at an average rate of 2% growth per year, which is the historical rate over the past five years. This forecast does not assume any significant additional, taxable development over the forecast period—such as the Chestnut Hill Square development project. Should this specific project come on line as currently defined by the developer, we estimate on the basis of expert testimony that it could generate approximately $2 million per year in new tax revenues for the years 2011 and 2012 (and perhaps more thereafter).

The Commission's Forecast also assumes that property tax abatement allowances will fall from 1.4% of the tax levy to approximately a 1% level as current disputes over the valuation of telecommunications properties get resolved in the near term. The 1% abatement allowance tracks the City's historical experience.

Intergovernmental Revenues. The Commission's Forecast assumes that state aid will grow at $1.4 million per year. This amount has been added to the relevant line item, which, we hasten to point out, includes other items that are expected to increase and decrease over the forecast period. Our assumed annual rate of growth in new state aid is equal to the city's low-end estimate shown at the bottom of Exhibit 2. There is a possibility, however, that state aid could increase by a factor of two (according to the Mayor's Office). Such an occurrence would have a moderate, positive impact on the operating budget in the early years of the forecast period.

Salaries & Wages. Based upon a historical review of wage and salary adjustments, the subcommittee feels that an overall 2.5% per year increase in total payroll expenditure is more likely than no increase at all—as currently assumed in the City's Forecast. While the City's Forecast acknowledges that each one percent increase in salaries would increase annual operating costs by approximately $1.5 million, it does not include any increases for salaries and wages. Going forward, the city will need to continue assessing the competitiveness of salaries and wages in order to attract and retain qualified municipal employees.

Benefits. Like most cities and towns in Massachusetts, Newton faces a large, unfunded retiree health benefit liability. As of June 30, 2006, this totaled $561 million. Were the city to change from the pay-as-you-go policy that is reflected in the forecast to an actuarial funded method, the annual expenditure on employee benefits would increase immediately by $38 million, rising to $44 million by the end of the forecast period (2012).

This projected increase reflects the pre-funding of a rapidly increasing liability. Municipal health care costs have increased by 63% from 2000 – 2005 across the State. During the five years ending June 30, 2006, Newton's total health care insurance expenditures increased by 54% or $10.4 million. That equates to the 11% annual average increase assumed in the Commission's Forecast model.

Since the city actually does not have authority from the State to create a trust for the funding of these benefits, the subcommittee has chosen to stick with the pay-as-you-go method of funding for modeling purposes.

Pensions. Along with health insurance, pension costs are a major expenditure growth item. The numbers included in both the City's and the Commission's Forecasts are predicated upon the most recent (January 1, 2006) actuarial valuation of the pension plan. The numbers also assume an 8% annual rate of return on plan assets. To the extent that this rate of return can be improved through participation in the Massachusetts Pension Reserves Investment Trust (MassPRIT), the city would have more flexibility to address the financial implications of increasing life expectancies of retirees and their dependents, and other financial needs of the city.

Supplemental Capital Maintenance. The subcommittee added this line item to the forecast as a result of due diligence that revealed a persistent under-funding of renewal of the city's physical capital.

Assuming (a) an estimated replacement value of the city's buildings, exclusive of the high schools, totaling $390 million (we excluded the replacement value of the two high schools because one is essentially new and the other is provided for in the mayor's capital plan and because the forecast covers a relatively short five-year period), (b) a need to invest at a rate of 3% of replacement value per year to maintain these buildings, based upon a recognized and widely used standard, and (c) a building life of 25 – 50 years, the city needs approximately $11.7 million each year for capital maintenance versus the currently projected spend of $4 million per year.

The $7.4 million gap between "required" and "current" capital maintenance can be bonded, meaning financed with bonds. Assuming a 20 year term for the bond and a 5% interest rate on the bond, it will cost the city approximately $750,000 in incremental expenditures each year to service the required debt (i.e., supplemental capital maintenance expenses for buildings would increase by $750,000 each year).

In addition, the subcommittee estimates an annual $2 million shortfall in funding for the maintenance of road and street infrastructure, which translates into an increase of $200,000 in debt service each year.

All in, the subcommittee foresees required supplemental capital maintenance expenditures of $950,000 per year going forward.

* * * * *

In sum, the city's changing financial picture deserves continued study and discussion. While the subcommittee reports a developing structural deficit of some significance, we hasten to add that that a narrow debate of (a) the numbers presented here and (b) related proposals of how best to close the widening gap between revenues and expenditures would miss the point of this forecasting exercise. The "big question" facing all of us is what kind of city do we want Newton to be. The city's management team, including the Mayor's Office and the Board of Alderman, has provided excellent support (and significant expertise) to this forecasting review. It's now up to us, as citizens, to make our collective aspirations explicit and figure out how best to shape our portfolio of wishes to the fiscal capabilities of the community.

Respectively submitted, January 4, 2007

Ruthanne Fuller
Amelia Koch
Tony Logalbo
Malcolm Salter, Chair

Newton's Capital Formation
Report of Blue Ribbon Subcommittee #2

Public infrastructure – roads, school buildings, police and fire equipment, libraries, parks, museums – is at the heart of the quality of life in a community. In an era of scarce public resources, when there is a temptation to defer major investments, it is especially important that capital spending, and its companion, spending on maintenance of capital assets, be periodically reviewed for adequacy. In its charge, the Blue Ribbon Commission was specifically asked to address this question:

> "(The Commission) should examine whether the appropriate balance is being anticipated for allocations between operational expenses and capital investment in the City and School plant and equipment over the next five years to avoid more expensive capital investments in the future."

Newton's Investment Policy

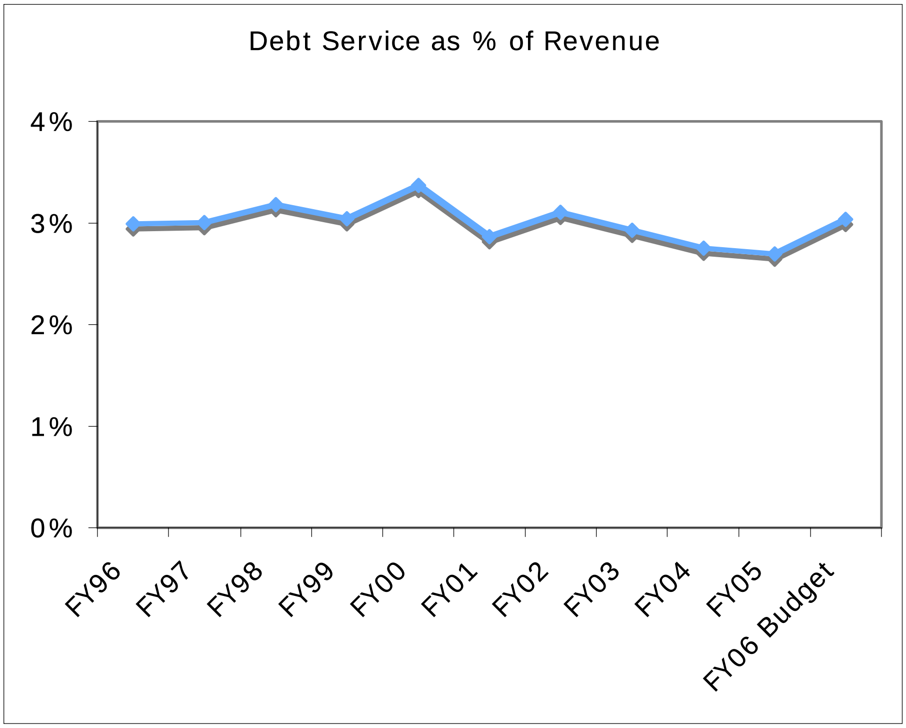
Newton has long recognized the need for explicit guidelines regarding investment. In 1981, Proposition 2 ½ had just been passed and Newton was preparing itself for a new tighter economic future. Fearing that the new fiscal pressure would mean significant budget cuts the executive branch sought to establish guidelines in a number of areas. City Comptroller David Wilkinson recalls these three that were intended to protect capital investment. The first was that free cash, or the end of year surplus, would be used only for capital projects. The second was to establish that items under $500,000 would not be bonded, and the third was that debt service, or interest and principal on bonded debt wouldn't be less than 3% of the budget and that if it were then the difference would be spent directly on capital items. The 3% was used as a placeholder since that was the percentage that debt service had been in recent years.

In the 1990s, the 3% policy was formalized by incorporation in the five year Capital Improvement Plan (CIP). That policy, as stated in the most recent CIP is:

> General Fund Debt Service will be approximately 3% of General Fund Revenue.
> Total capital expenditures will be approximately 5% of General Fund Revenue.

By virtue of the fact that the Capital Improvement Plan is reviewed and approved by the Aldermen, this policy was adopted by both branches of city government.

Throughout the past decade, Newton has been true to this policy: annual interest and principal payments have varied little from the 3% of revenue rule.



Data source: Comptroller's Office, City of Newton

Total capital spending over the past ten years was almost $110 million, or almost exactly 5% of the $2.2 billion in revenue available over that time.

Newton's Credit Standing

Newton has held the highest possible credit rating, without interruption, for more than thirty years from Moody's Investors Service, a nationwide independent credit rating agency.

A credit rating is akin to a report card. While the City's underlying property and income wealth is the foundation for its rating, the City's long-term management diligence and its response to fiscal management issues has earned it (in the MCAS lingo) a highly proficient score.

There are four primary areas measured by an independent credit rating agency:

1. Debt factors – how much debt is issued, for what term and how rapidly will it be repaid? What are the City's future debt issuance plans and will these plans create any unusual stress on the City's ability to repay its debt without constraining its current operations?

2. Economic factors – what are the economic factors of the community and region? Is the tax base diversified? What is the development growth potential and capacity?

3. Administrative factors – what is the community's record of sound financial management? What is the political environment? What efforts are made in capital investment and long-term fiscal planning?

4. Financial factors – what are operating results over a period of years? Tax collection percentages, reserve position and reserve policies? Capital infrastructure maintenance policies and practices?

There are also areas that are important to city residents that are not measured by a bond rating including the condition of buildings, roads, and parks. There's not a great deal the City can do about economic factors affecting the wider region and not a lot more development space in Newton. But the three other areas present both opportunities and pitfalls. Ideally the city would continue to manage in such a way as to preserve its Aaa rating, however in the long run a Aaa rating will not be maintained if city infrastructure and services are not maintained. Moving from a Aaa rating to a Aa rating would add approximately 5% to annual borrowing costs.

Is Newton's capital spending adequate?

Bearing in mind that debt is just one component of a strong credit rating, we reviewed available evidence of the adequacy of Newton's capital investment policy. As school buildings represent 85% of Newton's capital assets, this seemed a good place to look.

In April 2006 the Massachusetts School Building Authority (MSBA) released a Needs Survey Report describing the general condition of public school facilities throughout the Commonwealth. Teams of educators and engineers visited every public school in the state, a total of 1,817 schools. Using a standard survey to assess general conditions, they assigned each school a condition rating of 1 to 4.

The Report concludes that the condition of Massachusetts schools overall is generally good. 76% of the buildings received a rating of 1 or 2, meaning that they are generally in good condition, with a few building systems that may need attention. Less than 3% of schools (62 schools in total) received a rating of 4, meaning they are in poor condition and candidates for major renovation or replacement.

The Report found that there was little correlation between the relative wealth of a school district and the general condition of the school buildings within that district. Our city is a case in point. Over 30% of Newton's schools received a rating of 3, meaning that they are in fair to poor condition and need moderate to major renovation. These schools include: Angier, Cabot, Pierce and Zervas elementary schools, Brown Middle School, Newton North High School and the Newton ECC (pre-K program). 40% of Newton's schools received a rating of 2 and 27% received a rating of 1.

Massachusetts has spent a substantial amount on school construction and renovation – 63% of the state's schools are being reimbursed for projects undertaken between 1986 and 2005. During that period in Newton, however, only 41% of schools have received such state funding.

Newton's schools are considerably older than schools in Massachusetts. 32% of our schools were built before 1940, compared with 24% statewide. Only 18% of our schools were built after 1970, compared with 32% statewide.

Newton Schools		**Year Opened**	**School Rating**
Elementary Schools	A E Angier ES	1921	3
	Underwood ES	1924	1
	Cabot ES	1929	3
	John Ward ES	1927	2
	Franklin ES	1939	2
	Lincoln-Eliot ES	1939	1
	Williams ES	1949	1
	Bowen ES	1950	2
	Pierce ES	1951	3
	Memorial Spaulding ES	1954	2
	Countryside ES	1953	2
	Zervas ES	1954	3
	Mason-Rice ES	1959	2
	Horace Mann ES	1964	2
	C C Burr ES	1962	1
Middle Schools	Bigelow MS	1970	2
	F A Day MS	1971	2
	Oak Hill MS	1930	1
	Charles E Brown MS	1956	3
High Schools	Newton South HS	1960	1
	Newton North HS	1973	3
Pre-Kindergarten	Newton ECC	1975	3

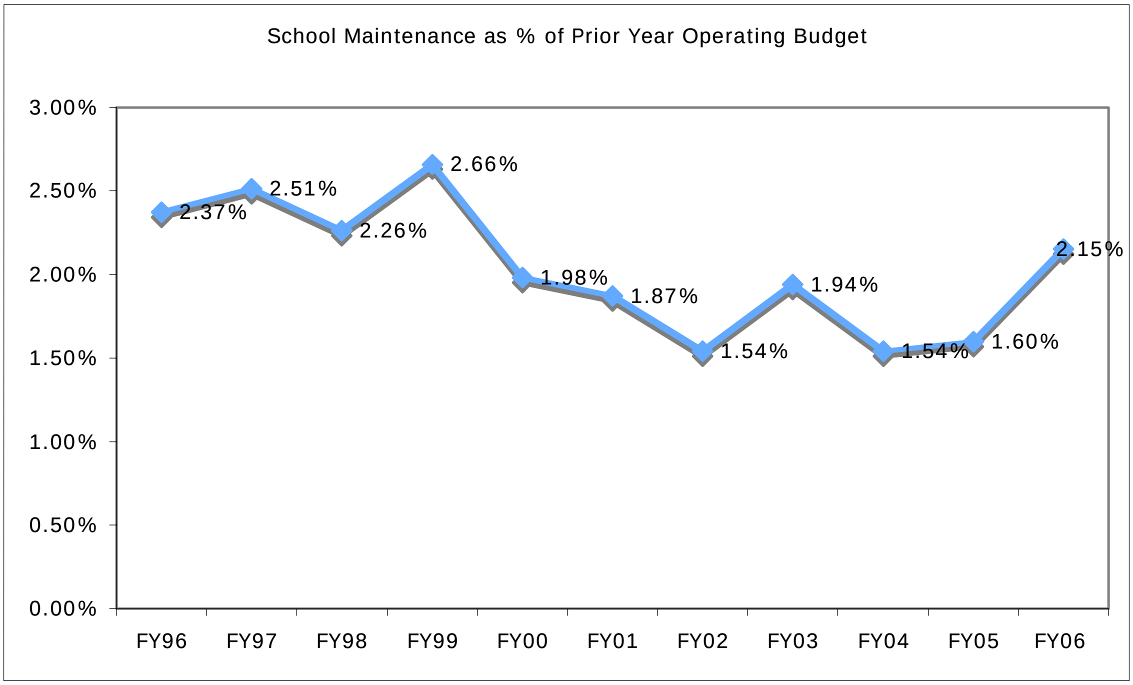
An integral component of the condition of assets is the amount of funds that are invested in their maintenance. Here again, the track record of school maintenance spending was reviewed.

Section 4-3 of the Newton City Charter establishes the following standard for school maintenance spending:

> (The School Committee shall) provide ordinary maintenance and repairs on all school buildings up to a maximum expenditure equal to two per cent of the School

Department's operating budget adopted for the preceding fiscal year.

Actual school maintenance spending was reviewed with an eye toward this guideline.



For most of this decade, maintenance spending has fallen short of the 2% goal. Each half of a percent point below the goal is worth roughly $700,000 in annual maintenance.

How does Newton's debt compare with other communities?

It's worth looking at other Massachusetts cities and towns to compare capital investment levels. To do this, we looked at how Newton's debt load compares with other municipalities also holding the highest credit rating. Of the 351 cities and towns in Massachusetts, only 13 hold a Aaa credit rating from Moody's. These include the cities of Newton and Cambridge, as well as eleven other towns: Andover, Belmont, Brookline, Concord, Dover, Hingham, Lexington, Wayland, Wellesley, Weston and Winchester.

Below are tables that compare Newton's debt service and outstanding debt per capita with the other Massachusetts Aaa communities. The data shows that, relative to its peers, Newton is underutilizing its debt capacity and, at least in terms of debt load, is a long way from jeopardizing its bond rating by taking on additional debt.

The table below shows FY05 debt service as a percent of the city or town's operating budget and also on a per capita basis. (In lay terms this would be like your annual mortgage payment on your house, compared to your total income, and divided by how many people live in your house.)

Massachusetts Municipal Debt Comparison -- "Triple A" Cities and Towns
Debt Service Percentages

Massachusetts City or Town	Bond Rating	Population	FY05 Operating Budget	FY05 Debt Service Total	as % of Budget	per Capita
NEWTON	**Aaa**	**83,802**	**284,263,989**	**9,268,477**	**3.26**	**111**
BELMONT	Aaa	23,604	80,522,395	4,753,898	5.90	201
WINCHESTER	Aaa	21,167	69,349,047	4,164,645	6.01	681
WELLESLEY	Aaa	26,515	95,987,511	6,037,175	6.29	228
BROOKLINE	Aaa	56,188	190,006,170	13,297,623	7.00	237
WAYLAND	Aaa	13,063	54,149,052	4,344,097	8.02	333
HINGHAM	Aaa	21,198	65,073,817	5,406,278	8.31	255
CONCORD	Aaa	16,919	59,795,621	5,275,858	8.82	312
DOVER	Aaa	5,657	22,977,082	2,065,215	8.99	365
LEXINGTON	Aaa	30,419	126,855,608	11,456,346	9.03	377
CAMBRIDGE	Aaa	100,771	406,774,722	38,540,434	9.47	382
WESTON	Aaa	11,595	59,968,025	7,439,454	12.41	642
ANDOVER	Aaa	32,141	114,893,386	21,890,543	19.05	681
Average		34,080	125,432,033	10,303,080	8.21	302

Data Source: Municipal Databank, Local Aid Section, Division of Local Services, Mass. Dept. of Revenue.
Website: http://www.dls.state.ma.us/mdm.htm
Notes: Bond Rating: Moody's 2006 bond rating; Population: 2004 Estimated US Census; Total FY05 Debt Service includes long term retired debt, long term interest and short term interest made this year on bond issues.

The next table shows the total debt outstanding in each community in FY05 and the amount per capita. (In lay terms, this would be like your total mortgage, divided by how many people live in your house.) It also shows the debt burden in relation to each community's assessed market valuation.

Massachusetts Municipal Debt Comparison -- "Triple A" Cities and Towns
Total Debt per Capita and Debt Burden as % Full Value

Massachusetts City or Town	Bond Rating	Population	FY05 Operating Budget	FY05 Total Outstanding Debt: Total	FY05 Total Outstanding Debt: per Capita	Debt Burden (Direct Net Debt as % of Full Value)
NEWTON	**AAA**	**83,802**	**284,263,989**	**109,108,798**	**1,302**	0.5
BELMONT	AAA	23,604	80,522,395	36,642,476	1,552	1
BROOKLINE	AAA	56,188	190,006,170	113,749,348	2,024	0.8
WELLESLEY	AAA	26,515	95,987,511	58,430,474	2,204	0.6
HINGHAM	AAA	21,198	65,073,817	47,976,087	2,263	1
LEXINGTON	AAA	30,419	126,855,608	69,145,059	2,273	1
WAYLAND	AAA	13,063	54,149,052	33,522,436	2,566	1.4
CONCORD	AAA	16,919	59,795,621	44,113,385	2,607	0.9
CAMBRIDGE	AAA	100,771	406,774,722	276,696,981	2,746	0.6
WINCHESTER	AAA	21,167	69,349,047	62,002,542	2,929	1.2
ANDOVER	AAA	32,141	114,893,386	103,888,000	3,232	1.4
DOVER	AAA	5,657	22,977,082	19,358,799	3,422	1.3
WESTON	AAA	11,595	59,968,025	85,989,710	7,416	2.3
Average		34,080	125,432,033	81,586,469	2,394	1.1

Data Source: Municipal Databank, Local Aid Section, Division of Local Services, Mass. Dept. of Revenue. Website: http://www.dls.state.ma.us/mdm.htm Debt burden data provided by First Southwest Company. Notes: Total outstanding debt refers to remaining principal payments that have not been paid off as of July 1 of the current fiscal year. Debt burden reflects direct net debt as a percentage of the full value of the property tax base.

As the tables indicate, the average debt service percent of budget for the 13 communities listed, including Newton, is 8.21%, compared to Newton's 3.26%. The average per capita debt service for the group is $302, compared with Newton's $111. The average debt outstanding per capita is $2,394, compared to Newton's $1,302. As a percent of budget and on a per capita basis, Newton's debt load is the lowest of its peers. Newton's debt as a percentage of the full value of its property tax base is also the lowest of its peers.

Maybe Newton could be proud of carrying the lowest level of debt -- if its capital assets were well maintained – but they are not. Our current level of capital spending is not sufficient to properly maintain our physical assets. Major and minor renovations of schools and other City buildings have been delayed, roadways and sidewalks are not replaced regularly and public recreational facilities are in obvious need of attention. Our impressive Aaa rating signals our access to favorable borrowing rates, but it is not an indicator of the quality of life in our public buildings and public spaces.

A higher level of borrowing to provide the resources for capital reinvestment could be supported through debt exclusion ballot votes. A debt exclusion vote permits taxpayers to approve or reject additional taxation for dedicated and specific capital purposes. Many of our Aaa peers use this tool frequently, as described in the table below. Every Aaa town has approved debt exclusion measures; only the cities of Newton and Cambridge have refrained from placing such initiatives before their voters.

Massachusetts Municipal Debt Comparison -- "Triple A" Cities and Towns
Summary of Debt Exclusion Votes

Massachusetts City or Town	Number of Elections containing Debt Exclusion Questions (1982 - 2006)	Number of Separate Debt Exclusion Questions posed in these Elections		
		Passed	Failed	Total
ANDOVER	2	3	1	4
BELMONT	7	6	1	7
BROOKLINE	2	2	0	2
CAMBRIDGE	0	0	0	0
CONCORD	10	11	2	13
DOVER	15	27	2	29
HINGHAM	9	12	4	16
LEXINGTON	3	5	0	5
NEWTON	0	0	0	0
WAYLAND	12	12	1	13
WELLESLEY	7	10	1	11
WESTON	29	70	0	70
WINCHESTER	2	2	0	2

Note: A ballot may contain one or more debt exclusion questions. The figures in column two above summarize the number of times towns have had debt exclusion elections over the 1982 to 2006 period. The figures in columns 3, 4, and 5 reflect the total number of separate debt exclusion questions placed those ballots over the 1982 to 2006 period and whether the questions passed or failed.

Data Source: Municipal Databank, Local Aid Section, Division of Local Services, Mass. Dept. of Revenue.
Website: http://www.dls.state.ma.us/mdm.htm

Capital Investment Planning

In his State of the City address, Mayor Cohen announced a $250,000 funding request for a capital needs study of 25 of the largest municipal sites. Recently the School Department issued a request for proposals for architectural services to perform an assessment of Newton Public Schools' space and facilities needs, including cost and schedule comparisons. The end product will be:

- an electronic database containing current information about the buildings
- a set of standards for elementary schools in the district
- an assessment of how each building conforms to these standards
- a recommended approach and timetable for addressing bringing buildings up to standard; and
- a hierarchy of needs with priorities listed.

These actions are welcomed by the Commission and are long overdue. Capital investment should be needs driven, within fiscal constraints.

Recommendation

The Commission has examined the various measurements used by the rating agency and is of the opinion that the City could maintain its existing credit rating while significantly increasing its present level of outstanding debt and modestly extending its currently rapid debt retirement schedule.

While there are many measures used by the credit rating agency, one of the key measures is the City's debt in relation to its assessed market valuation. Newton ranks very low on this measure. Even if we assume the issuance of debt for Newton North High School, Newton would still have ample room on this measurement to support a more robust annual capital financing effort. It is not concern about maintaining the City's credit rating that imposes a practical limitation on higher debt levels, but rather the identification of the resources available to repay debt. At June 30, 2006, the City had $39.3 million in outstanding tax-supported debt. It is likely that this amount could be increased substantially and still remain within the parameters associated with a "Triple-A" rating.

In the following tables, the Commission has attempted to quantify the additional debt issuance for capital infrastructure investments that might be supportable within the existing debt management policy allocating 3% of the City's budget to debt service. We have also examined the debt financing that might be possible at higher allocation levels (4% and 5%) in each instance.

		Debt service Budget @			Increments		Additional Principal that could be supported	
Fiscal Year	Commission revenue forecast	3%	4%	5%	@ 4%	@ 5%	@4%	@5%
2008	$268,457,120	$8,053,714	$10,738,285	$13,422,856	$2,684,571	$5,369,142	$26,845,000	$53,690,000
2009	277,298,476	8,318,954	11,091,939	13,864,924	2,772,985	5,545,970	1,550,000	3,100,000
2010	285,553,085	8,566,593	11,422,123	14,277,654	2,855,531	5,711,062	1,540,000	3,080,000
2011	293,731,332	8,811,940	11,749,253	14,686,567	2,937,313	5,874,627	1,560,000	3,120,000
2012	304,091,067	9,122,732	12,163,643	15,204,553	3,040,911	6,081,821	1,820,000	3,640,000
					Total for five-year period:		$33,315,000	$66,630,000

Making the simplifying assumption of 20-year debt at 5% interest, adding **1%** immediately to the debt service target cap for FY08 would support debt service on $26.8 million now and smaller additional amounts in subsequent years, totaling $33.3 million new issuance for the five-year period. Alternatively, following a strategy of increasing the debt service budget gradually over the five-year period FY08-12, raising the allocation by 0.2% steps to reach a **4%** target in year 5, would support about half as much new debt issuance - about $16.5 million - spread evenly over the period. Setting a **5%** target, either immediately or gradually, doubles these estimates. To the extent that some debt issu

The Commission is not prescribing a new debt management policy. Allocating a higher proportion of the City's budget to capital purposes is a complex matter that will involve considerable thought and careful evaluation of trade-offs within the existing budget. However, the Commission does conclude that the present level of annual capital spending is not sufficient to maintain the City's physical assets. A higher level of annual debt issuance to provide the resources for needed capital reinvestment could conceivably be supported through debt exclusion ballot votes – by which the taxpayers would decide whether to approve or reject additional taxation for dedicated and specific capital purposes. Many of the Massachusetts communities with the highest credit ratings use this tool, along with operating overrides, to place before the voters decisions about maintaining the long-term municipal assets. If Newton's capital reinvestment program cannot be supported by a shift from within the existing budgetary resources, then we urge the City's consideration of this additional tool.

Closing the Gap
Report of Newton Subcommittee #3
December 17, 2006

"The Commission should review what measures might be feasible to close any gap between anticipated expenses and anticipated revenues over the next five years, and if so, what they might be."

As such, subcommittee #3 looked at where expenses might be cut and where additional revenue might be generated. Cutting expenses did not seem feasible in light of the current fiscal situation. We identified several areas though where we thought the budget could be impacted; commerical zoning, pension benefits, health benefits, PILOT programs, (payment in lieu of taxes) and energy savings.

Potential Revenue enhancements/cost savings

	High	Low
Pilot Programs (yearly)	$4,465,121	$1,506,402
New Commercial Property	$0	$0
Recycling (yearly)	$200,000	$0
Pension Savings*(cumulative	$65,000,000	$82,000,000
Energy Efficiencies	$2,000,000	$0

* (savings do not start to kick in until years 2018-2020 and only if the performance of the pension plan is improved according to recommendations) These savings would primarily fund the current unfunded pension liability.

PILOT Program:

PILOTs are voluntary or negotiated payments made by tax-exempt organizations. While the Dover Amendment[*] prevents Newton from having the political leverage of Boston and Cambridge, which are exempt from this law and receive significant PILOTs, we believe that the tax exempt properties, notably the colleges and universities, should contribute significantly more than they now do. Boston College pays Newton just $100,000 per year and other Newton colleges, including Mount Ida and LaSalle, make no contributions. The arrangement with Boston College dates back about twenty years under an agreement negotiated by Mayor Mann.

[*] The Dover Amendment is the common name for MGL Chapter 40A, Section 3, which exempts agricultural, religious, and educational corporations from many zoning restrictions. It allows a facility that provides certain services, educational chief among them, to ignore local zoning laws and build the facility it needs to provide those services. The ability of local officials to challenge such a facility is very limited. Efforts to lobby the legislature to change this law have been unsuccessful.

It is instructive to see what other PILOTS have been negotiated. Boston, Cambridge and Providence, Rhode Island receive the following as reported by the Newton Finance and Management Working Group, June 15, 2005:

CAMBRIDGE	
• Harvard	$1,772,264
• MIT	$1,223,000
• Whitehead Institute	$390,000
BOSTON	
• Boston University	$3,200,000
• Harvard	$1,600,000
• Boston College	$215,000
• Berklee School of Music	$175,000
• Northeastern	$137,000
PROVIDENCE (RI)	
• Split among 4 private universities	$2,500,000

While universities are among the largest PILOT contributors, PILOT revenues in other communities include other tax-exempt institutions. Boston's agreements with more than 40 institutions contribute as of 2003 more than $23 million annually to the city. In Cambridge PILOTs total about $3.6 and Brookline approximately $1 million. Watertown recently negotiated a PILOT with Harvard as a result of the university's purchase of the Arsenal Mall property. The town receives $1,747,625 in FY '07 and the amount climbs to $1,886,476 in FY '10, a yearly increase of approximately 2.7%.

Newton's tax-exempt entities own properties with an assessed value exceeding $1 billion. However, after excluding properties owned by governmental entities (city, state, federal), religious institutions and the Newton Housing Authority, the assessed value of the remaining properties is $723,894,30, according to Elizabeth Dromey, Director of Assessment Administration, The assessed values of the land and buildings of the five post secondary education institutions are:

Boston College:	$355,465,100
Lasell College:	$55,412,000
Mt. Ida College:	$38,451,000
Andover Newton Theological School:	$2,541,800
Hebrew College:	$3,517,400

If these five tax-exempt institutions were taxed at the appropriate residential or commercial rate, these schools would pay $5,915,160 in taxes.

We recognize that starting a significant PILOT program will be challenging for the city and these institutions. Yet the constraints placed on Newton by Proposition 2 1/2 demand that these institutions be open to a significantly greater financial contribution to Newton. These institutions directly benefit from the quality of service provided by Newton's police, fire and public works departments and indirectly through all services that contribute to the quality of life in the city.

Recommendations:

While we do not minimize the political challenge of breaking from the historical pattern, we believe that now is the time to use the city's "bully pulpit" to engage the major tax-exempt educational institutions in negotiations about a more significant contribution to the city. A contribution at 75% of the assessed value of these post-secondary institutions would result in an annual PILOT of $4,465,121; at 50% the annual PILOT would be $2,993,637 and at 25% $1,506,402.

RECYCLING PROGRAM:

Building on the city's strong recycling program, we recommend expanding recycling revenues by starting a "No Visible Recycling Campaign" and fully involving the school system in a citywide effort. A "No Visible Recycling Campaign" entails the city actively working to ensure that residents recycle all recyclable materials that are visible at the time of trash curbside pick-up.

While recycling was started in schools as educational programs, by 2006 recycling has become a legitimate management responsibility. An audit of the school buildings will reveal what physical resources (e.g. cleaning stations) are needed to safely recycle paper, glass, tin and plastic and the options for negotiating with the custodial staff about this work. Current revenues from recycling in the city are about $320,000 and there is the potential for cost savings and revenues of an additional $200,000 or more through both expanded school recycling and most significantly by enforcing existing city mandates. mandates. According to Elaine Gentile, Director of Environmental Affairs, Newton could derive substantial financial advantage by reducing the amount of trash and increasing the amount of recycling. Other communities have done this successfully and we recommend that the city develop and implement a plan for Newton.

PENSIONS

As of January 1, 2006, the City of Newton had $253 million of actuarial assets ($246 million market value) in its pension plan. At that date the city had an unfunded actuarial accrued liability ("UAAL") of $129 million. Projected out over 22 years, this totals, with interest, approximately $313 million. This is the amount that the city must pay over time into the retirement system. The implied actuarial rate for this is 8%.

The city currently has a pension board composed of representatives of the Firefighters' and Patrolmen's unions and one Mayoral appointee, unconfirmed by the Board of Aldermen. The City Controller serves as an ex officio member of the board and a fifth member is selected, without confirmation, by the other four members. Segal Advisors, a pension consultant, has been employed by the board for 15 years.

For the past 10 years, the Newton plan has underperformed the Massachusetts Pension Reserves Plan (herein after referred to as PRIT) on average by 1.43%, on an average base of \$225 million, the underperformance has cost the plan, and therefore the city, over \$30 million. In the past year alone, the underperformance has exceeded 5%, for a cost of over \$12 million. Each 1% in underperformance, at present, costs the taxpayers \$2.5 million a year, increasing to more than \$8 million per year by the time full-funding is expected to be achieved during fiscal year 2028 as this is the pay-in requirement for the pension shortfall. The total underperformance exceeds \$112 million without interest and an additional \$65 million with interest totaling \$177 million.

U.S. Ranking of PRIT "Core" Fund
Relative to Public Pension Funds*

For Periods Ending June 30, 2006

	YTD as of 6/30/06	1-Year as of 6/30/06	3-Years as of 6/30/06	5-Years as of 6/30/06	10-Years as of 6/30/06
PRIT Fund "Core" Return	5.55%	15.49%	16.10%	8.77%	10.29%
NEWTON		10.35%	11.83%	5.88%	8.86%
PRIT Percentile Ranking	6th	2nd	2nd	5th	5th
Public Fund Median Return	3.42%	9.44%	12.24%	6.57%	8.42%

Source: Trust Universe Comparison Service (TUCS) Master Trust Report, for periods ending 6-30-06

(* Public Pension Plans with over \$1 Billion in Assets – Updated Quarterly)

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Recommendations:

The management of the Newton retirement plan should be moved to the PRIT plan. At \$43.5 billion, the PRIT plan has the advantage of in house full-time professional managers and the choice of the highest rated money managers to manage the assets. It is very difficult for a fund the size of Newton's to attract the top managers, and this will continue. If the Newton fund does this, and only picks up another 1% in return each year, then the pension shortfall will be reduced by approximately \$65 million and be fully funded eight years earlier than presently planned by fiscal year 2020.

If the difference is the historical average of 1.43%, then a savings of more than \$82 million would result from savings in interest alone. Investment returns would be increased by nearly $170 million so that total fund performance would be improved by more than $252 million, and the system will be fully funded ten years earlier than expected by fiscal year 2018.

In this day and age, almost all non-profits have investment committees comprised of money managers from either their boards of directors, communities, etc. Whatever choices the city makes, it would behoove it to cull from our very talented citizenry to get a volunteer/appointed investment committee to augment the existing committee. At the minimum, the Mayor's appointee to the committee should be someone from the investment community. Although other municipalities have not done this, Newton could set the standard and bring municipal pension management into the 21st century.

A second opportunity would be to issue pension obligation bonds.

ENERGY SAVINGS AND SUSTAINABILITY

Introduction

During the fiscal year 2007, Newton is expected to spend slightly more than <u>$8 million</u> on energy: electricity – 65%; natural gas – 15%; heating oil – 20%. By the end of fiscal year 2012, the yearly energy budget is expected to exceed <u>$10.5 million</u>. Budgetary savings in excess of 20% of these amounts is believed to be easily achievable.

In addition to saving the City money on energy bills, The Newton Citizens Commission on Energy has identified these qualitative goals:

To better care for our local environment,

To protect public health,

To use resources wisely and efficiently,

O To plan ahead to continued growth and consumption needs.

The United States Conference of Mayors earlier this year established the ambitious objective of zero greenhouse emissions within 20 years from now and mayors representing nearly 50 million American citizens have already agreed to pursue this goal.

Newton has the opportunity to demonstrate leadership while working toward the achieving of all of the above goals: budgetary savings, enhanced quality of life for Newton residents with an improved environment, and reduction in CO2 and other greenhouse gases.

Recommendations:

In his November 20, 2006 State of the City Address, Mayor David Cohen reminded us that "Of our 15 elementary school buildings in Newton, the youngest turns 40 next year. Thirteen are over a half-century old, and seven have undergone no major upgrades since the 1950's. The School Department has allocated $250,000 for a capital needs study, the first step in a process that will bring all of our schools up to modern standards." He then went on to say: "...I am pleased to announce that I have taken the first step in the process of reinvigorating our entire public building stock. In this year's Capital Improvement Plan..., I've requested $250,000 from the Board of Aldermen for a capital needs study of our 25 largest municipal sites. This study is the first step toward creating a priority list for bringing the interior systems and exterior conditions of our city buildings up to code, energy efficient, and safe."

The above necessary first steps to restoring Newton's municipal building stock should be complemented by energy audits in order to identify as many opportunities for improvement in energy use efficiency and sustainability, the "priority list" referred to by the Mayor. After being identified, these opportunities should be prioritized and evaluated by the use of standard life cycle costing, so that "first cost" of any project is not determinative.

After the priority list of projects has been determined, financing options would need to be considered. As was noted in the May 2005 report of the Newton Finance and Management Working Group , chaired by Alderman Ken Parker, those options were, and remain, principally "...municipal bonding and performance contracting [Energy Services Company], in which a private entity finances design and implementation for a portion of the savings achieved." Of the two options noted, the Newton Finance and Management Working Group found "...municipal bonding to be preferable, since interest rates are lower, control is maintained locally, and more of the savings accrues to the City...". The 15% to 25% of project cost awarded to an Energy Services Company ("ESCO") is in addition to the project cost and represents a variable amount of total energy savings achievable by the City. This high cost must be viewed in light of services provided by the ESCO and guaranteed savings. It must also be viewed in light of the practical outcome that the projects producing the largest savings and accordingly highest ROI's and shortest paybacks will be the most likely projects undertaken, leaving many other worthwhile projects not undertaken for want of sufficiently high early cost savings.

Savings resulting from the above process may initially provide all or at least a portion of project debt service and will ultimately enhance the City's operating budget.

POTENTIAL REVENUE ENHANCEMENT IDEAS

Revenue from Commercial Property:

The City receives property revenue from two sources: 1) property taxes, and 2) taxes on new growth construction. During the past 20 years, there has been a dramatic increase in the percentage of property taxes that are derived from residential properties (73% in 1986 to 83% in 2005), and a corresponding decrease in the amount derived from industrial and commercial properties. This rise is primarily attributable to the faster rise in residential property values than that of commercial values. However, New Growth revenues have also moved almost entirely to residential construction (86% in 2006, compared to 49% in 2001 or 55% in 1992), with very little new commercial construction during 2005 or 2006. And Newton's New Growth revenues per capita at $26 in 2005 are the lowest of nine surveyed neighboring towns, and one-fifth of the New Growth seen in Cambridge – a city with vibrant new development. Traditionally Newton has held a healthy balance in its residential/commercial split, with less commercial property than Cambridge and Waltham, but far more than the further western suburbs of Lexington, Wellesley or Weston. For this reason, we wanted to examine the potential opportunities for reversing or stabilizing the trend of residential properties carrying an increasing share of the tax burden.

However, we discovered two fundamental impediments to increasing revenues from commercial properties:
1) A lack of available parcels that could be put together for a meaningfully-large commercial property of the size to hold an office park or a small research facility, and
2) current zoning laws and procedures that implicitly and explicitly discourage commercial development (specifically projects in excess of 20,000 square feet).

These issues have been examined in great depth by the Comprehensive Planning Advisory Committee, who issued a thoughtful planning advisory guide which is currently under review by the Board of Alderman. One of the conclusions of this Plan is, "while development makes an important contribution to the community's economic health, this City can't rely on building as a primary means of resolving fiscal strains." (page 10-9) The Plan does not recommend an overhaul of the current zoning laws or procedures (to a more commonly-practiced 6-member Zoning Board charged with implementing and interpreting clearly delineated regulations). Instead, this Plan recommends incremental change, as exemplified by the Seven Early Action Efforts, including clarification of home business zoning, or preferential treatment for special permits which utilize green design.

Our discussions with developers who are active and interested in Newton indicate that there might be some opportunity to attract new development via a necessary change to antiquated zoning regulations for Mixed Use Districts (co-located residential and commercial) development. Mixed-use development is currently very popular with developers as one of the most financially-viable vehicles. (Newton's Mixed Use zoning needs to be modified to allow more reasonable density, as well as to have several measurements – lot area per unit, FAR, yards, maximum height, and building coverage – work together reasonably, (which is currently not the case.)

However, even with necessary zoning changes, without a more comprehensive change to Newton's permitting procedure, commercial development is not likely to increase dramatically within the city. In addition, public sentiment appears unwilling to encourage commercial development (even in the most attractive transit-oriented locations such as Newton Centre) because of concerns of traffic, parking, and change to the residential fabric of the city's neighborhoods.

<u>Recommendation</u>:

An explicit effort to increase commercial revenue is not a viable strategy within the foreseen five-year time horizon.

HEALTH INSURANCE SAVINGS

The city offers two health insurance options to all current and retired employees, their spouses, and dependants. The city currently contributes 80% of the cost. The city is self-insured and uses Tufts Health Plan and Harvard Vanguard to provide services as third party administrators (TPAs). As such, Tufts and Harvard structure plans and pay claims on behalf of the city and but the city is responsible for all costs. The city maintains a "stop loss" insurance policy that protects the city in case a single claim or a series of claims exceeds an agreed upon threshold.

The city bids the TPA contracts out annually and keeps two providers in order to maintain competition and keep costs down. In addition the city has adjusted co-pays and deductibles frequently to remain competitive and current levels ($15 for office visits, $50 for emergency room visits, and $150 per inpatient admission) are competitive with what other cities and towns, and other organizations, are using in their policies. December 1, 2004 the city began by purchasing drugs from Canada as another cost saving measure. The first few years it cost the City slightly more money but saved the employees. The City is now saving money with the addition of a generic and over the counter drug program. Savings to date are estimated at $15,000.

Most of Newton's 2680 current employees are members of a union (only about 325 are not) and by state law health care is subject to collective bargaining. Changing the employee contribution, which shifts costs and future increases to employees, and all other changes in plan design must be negotiated. The city is subject to State regulation Chapter 32b and must contribute at least 50% of the cost of health insurance. Newton currently contributes 80%. The city last surveyed other cities and towns in May of 2003 when the average city/town contribution was 76% with towns tending to be closer to 50% and cities tending to be far higher. In addition to active employees, the city insures about 2245 are retirees. The retiree group includes members of the Board of Aldermen, the Election Commission, the School Committee and other elected officials because they are defined as employees under state law.

They get the same benefits, including health insurance, retirement, and life insurance including post retirement benefits as do all other Newton Employees.

One possible route for future savings would be to revive a May 2006 attempt to exempt health insurance from collective bargaining as has been done at the state level. The state passed legislation exempting health insurance from collective bargaining for state employees. In the spring of 2006, the state legislature considered a similar amendment that would have exempted health insurance from collective bargaining for cities and towns as well. The Massachusetts Municipal Association (MMA), a nonprofit, nonpartisan association, issued a report in 2005 on the health care crisis that strongly advocates for this legislation and provides data relative to the effect of rising health care costs on municipal budgets. The report states that health care costs for cities and towns rose an average of 63% from 2001 to 2005 consuming approximately four out of every five dollars of the 2.5 percent annual growth in taxes on existing properties allowed under Proposition 21⁄2. The full MMA report is included as an appendix. Newton's average increase over the past ten years is about 11% per year.

One other possible future route for savings would be to join the state health insurance plan. This option is not available at this time but is under consideration at the state level. This option should be evaluated if the opportunity arises. Also, the city has considered treating retirees differently than current employees, which is allowed outside of collective bargaining; however some retirees' pensions do not cover their portion of the premium at the 20% contribution rate, so the city is reticent to increase the contribution rate.

<u>Recommendation</u>

The city has a few options for cost savings with regard to health care and the best ones are up to the state to allow/provide. The ability to make changes to health benefits with out needing to negotiate every aspect would make it possible to build in incentives and make smaller more frequent changes in line with the market place rather than negotiating each change. The possibility of joining a state plan would also be good to have as an option. City staff has been diligent in taking what steps are available to them to keep costs down. The city should maintain those efforts and press the state legislature for changes.